SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
Produced by the SIA Research Department

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The Grass Is Always Greener

U.S. Activity In Foreign Securities

Given the onset of the Mideast crisis August 2, one might have thought, based on historical experience, that the U.S. investor would retreat homeward, perhaps by selling off foreign equities and buying U.S. bonds; the traditional "safe haven" approach. Instead, U.S. investors made additional net purchases of foreign equities in 3Q90 of $810 million. While certainly a modest figure, we believe the 3Q90 pattern indicates that U.S. investors have faith in foreign equity markets despite the precariousness of the world's political and economic situation. Year-to-date acquisitions of foreign equities is now at $7.3 billion. This amount is below last year's pace but still good enough, by far, for the second highest level ever.

U.S. Net Purchases of Foreign Financial Assets
($Bils.)

	I-III 90	*I-III 89*
Equities	$ 7.3	$ 9.4
Debt	15.6	5.3
Direct Investment	33.0	27.7
Total	$55.9	$42.4

Interestingly, in the month of August, U.S. investors made net purchases of $90 million of foreign equities. In sharp contrast, SIA's *Investor Activity Report* indicates that institutional investors were actually net sellers of U.S. equities totalling $1.8 billion in August. Given the different sources of data, we do not believe a perfect direct comparison is appropriate; however, the trend is indicative of the U.S. investor's serious commitment to portfolio diversification.

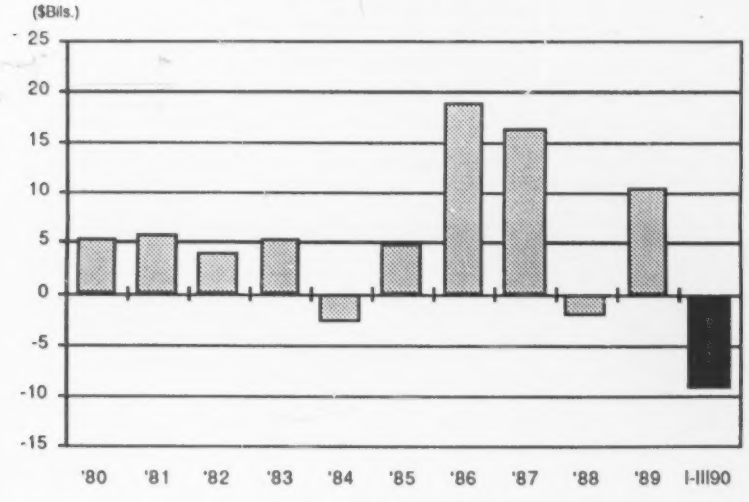
On the fixed-income side, U.S. investors nibbled at foreign bonds in 3Q90, making net purchases of about $665 million. Although off the pace of the previous quarters, the total for the year is now $15.6 billion, double any earlier year. In comparison, institutional net purchases of U.S. corporate bonds through the first half 1990 are, on an annualized basis, down 25% from the prior year. We further note that the U.S. investors' preference for foreign bonds in 1990 relative to foreign equities is the mirror image of their posture in 1989 and consistent with the current high interest/rate lower equity price environment.

As we've explained before, we continue to believe that the higher yields on foreign bonds, combined with strong foreign currencies and a weak dollar, have made foreign fixed-income instruments attractive. Also, given the recent downgradings/defaults on U.S. corporate bonds (defaults on corporate debt payments will reach a 20-year high in 1990) U.S. investors may be viewing foreign bonds as a "substitute" instrument. Not only can U.S. investors buy foreign sovereign issues of developed countries, but they are practically default free.

Finally, we note the substantial U.S. direct investment in 3Q90 of $19 billion. This brings the 1990 total to $33 billion, just about equalling 1989's full year total. So, while portfolio investors took a cautious stance in 3Q90, U.S. investors significantly upped their stake in the global economy through direct investment.

Foreign Activity In U.S. Securities

Foreign Participation In The U.S. Equity Market Continues To Suffer



It was still another quarter of selling for foreign investors with net sales of U.S. equities of $2.4 billion during 3Q90. As has been the pattern this year, European

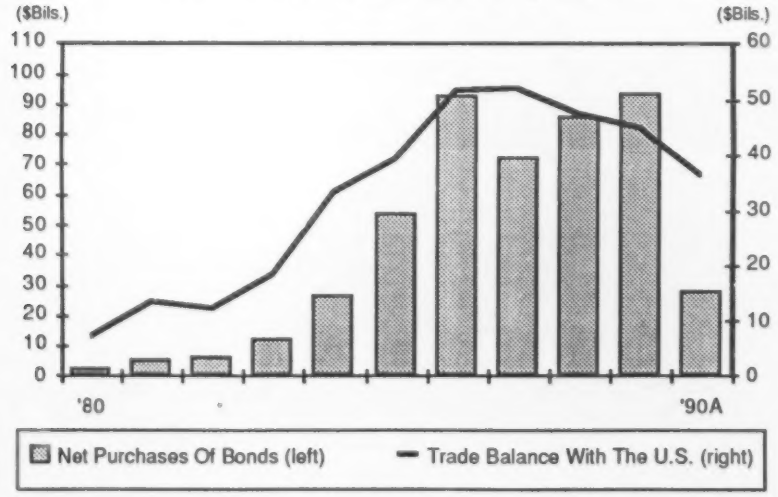
investors were the largest divestors of U.S. equities; net sales nearly reached $2.6 billion for the quarter and now total $6.2 billion for the year. For all foreign investors the year-to-date figure now stands at $9.2 billion and is in stark contrast to net purchases of $10.8 billion in the same period last year. Foreign investors though, made net purchases of U.S. equities totaling $1.4 billion in July, halting eight consecutive months of net sales. So, despite all the negatives, a declining dollar, rising interest rates, inflation worries and a weakening economy, foreign investors were following U.S. equity prices up to near record highs in July.

Foreign interest in U.S. equities, however, was abruptly interrupted this year. The eruption of the Mideast crisis in August quickly shifted the attitude of foreign investors away from U.S. equities; net sales totalled $1.3 billion in August. The pessimistic tone carried over into September as net sales exceeded $2.5 billion in that month alone.

Foreign Activity In U.S. Treasuries

Net purchases of U.S. Treasuries totalled $11.2 billion in 3Q90. Investors from Spain, the Netherlands and Germany were the most active net purchasers of U.S. government securities. Data available by type of investor (central bank or private sector) indicate that central banks were the major participants in this market. Given the sagging fortunes of the dollar in August, central banks may have decided to support the dollar by purchasing Treasury bonds rather than letting the dollar fall to "undesirable" levels. Despite central bank support, the buck still took a big hit in August, losing 6.1% to the Swiss Franc, 2.3% to the British Pound and nearly 1.4% to the Japanese Yen.

As The Japanese Trade Surplus With The U.S. Falls So Does Their Net Purchases Of Foreign Bonds



The Japanese continue to show little interest in U.S. Treasuries in 1990 andmade net purchases of only $445 million in 3Q90. This leaves their year-to-date divestment at a substantial $7.9 billion. Given a declining Japanese/U.S. trade surplus, economic difficulties in their home market, and new investment opportunities in Europe, support from these investors, the largest foreign investor in the U.S. Treasury market since the mid-1980's, may continue to cool. Indeed, data from the Japanese Ministry of Finance indicates that the Japanese investors' abandonment of foreign bonds in 1990 is worldwide, as net purchases on an annualized basis will be at there lowest level since 1983.

Foreign participation in the U.S. Treasury market continues to be cautious. At the current pace, net activity at the end of 1990 will be at its lowest level since 1983; hardly encouraging for a country with a troublesome budget deficit and a declining savings rate. While OPEC may re-cycle newly found petro-dollars into the U.S. Treasury market, at least temporarily serving as a buffer for the loss of Japanese and German capital, foreign capital will be harder to draw on given higher interest rate trends elsewhere along with strong foreign currencies. This means that the U.S. deficit will increasingly have to be financed domestically, a sharp reversal from trends in the 1980's. To many observers, this change in financing will be favorable for the U.S. in the longer run as we will have greater control over our own economy. However, in the shorter-term this turn of events means higher interest rates and a lower U.S. dollar, other things constant.

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